A Critique of the Economic Basis for the Western Wireless Portability Position

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The Purpose of My Discussion

- To rebut the economic case presented by Steven Parsons on behalf of Western Wireless
- To explain why wireless ETC support must be based on their own costs
- I take, as a starting point, that multiple ETCs, including wireless ETCs, have already been designated in an area
- Determining the "public interest" has been, and will continue to be, addressed by NTCA and OPASTCO in its own right

The Act's Special Treatment of Rural Areas and Rural Carriers

- The Rural Exemption (Sec. 251(f))
- "public interest" test for multiple ETCs (Sec. 214 (e)(2))
- "reasonable comparable" rates and services for rural areas (Sec. 254)
- "specific, sufficient, and predictable" support (Sec. 254 (b) (5))
- Competition is not the goal of Sec. 254 (b); access to quality services ,comparable rates and services are

<u>Faulty</u> Western Wireless Economics, as presented by Steven Parsons

- Economic efficiency, competition, and universal service go hand in hand
- Competitive neutrality, basing support on forward-looking economic cost, and elimination of rate-of-return regulation are essential for economic efficiency.
- There is little or no net cost to the Western Wireless policy prescription, due to historical inefficiencies of ILECs and the way they have been regulated.

Competition does not necessarily engender universal service

- Case in point: airline deregulation, essential air service, and rural rates/services
- Case in point: railroad deregulation, freight exit, unsuccessful passenger subsidies
- Rural areas should be concerned about deregulation (recent Brookings volume contained no hits for "rural" in airline or railroad chapters, only in telecom)
- Congress was cognizant of the difficulties that competition poses for universal service – this is reflected in numerous provisions of the Act

Forward-looking cost is <u>not</u> essential for economic efficiency

- The <u>theoretical</u> advantages of forward looking costs can be undermined by practical problems
- Embedded costs are monitored by owners, regulators, NECA, capital markets, others
- The difficulties of auditing embedded costs are nothing compared with the problems of auditing forward-looking costs
- Current models are inaccurate for disaggregated geographies and promise a costly regulatory process
- Use of embedded cost for rural ILECs is prudent

Rate-of-return regulation for small rural telephone companies is not inefficient and is good public policy

- <u>Theoretical</u> advantages of incentive regulation apply only to pure price caps – efficiency gains, as actually practiced, are smaller
- The <u>practice</u> of rate of return regulation makes it more efficient than WW suggests: time lags, average schedule,…
- Empirical evidence shows weak (at best) gains with the large carriers
- We should expect smaller gains (if any) applied to small carriers

- Heterogeneity, volatile investment patterns, lack of relevant productivity gain evidence all pose costly administrative problems
- Incentive regulation would require significant increases in QoS monitoring
- Efficiency "gains" may take the form of reduced investment in the network (e.g., broadband service provision)

The Regulatory Compact

- ILECs made significant investments in high cost areas and agreed to recover these investments over long periods of time
- This was achieved via rate of return regulation and the use of embedded cost
- Departures from this regime "break" this compact and have efficiency consequences for future investment in rural areas

Parsons: example

Monthly Costs	Incumbent	Entrant	Total USF
Fixed Cost	$10,000	$8,000	
Line-Sensitive Cost	$10	$8	
Lines pre-entry	1000	0	
Total Cost pre-entry	$20,000	0	
Per-line USF	$20	0	
Total USF pre-entry	$20,000	0	$20,000
Lines post-entry	900	300	
Per-line cost post-entry	$21.11	$34.67	
Total cost post-entry	$19,000	$10,400	
Per-line USF	$21.11	$21.11	
% of total cost recovered from USF	100%	61%	
Total USF post-entry	$19,000	$6,333.33	$25,633

Lehman Analysis: CETC Support based on ILEC costs raises the price of universal service.

- Parsons' measure is irrelevant
- Example shows that USF increases under WW portability position: from $20,000 to $25,633
- Example shows that using ILEC costs for CETC support does not provide universal service at minimum cost
- Example raises questions about the extra (200) supported lines and increased cost for the originally supported (100) lines: from $20,000 to $19,000+$2111=$21,111
- CETC support will be even more excessive if the CETC is lower cost; if the same cost structure can serve 1000 lines, then their costs are only $16/line
- Analysis of example demonstrates why identical support rules should be eliminated.

  Competitive neutrality does not require that CETC support = ILEC support

Differences between wireless and wireline services include:

- Cost structures and service areas (addresses?)
- Quality of service
- Revenue streams
- Regulatory treatment
- (un)equal access
- Pricing structures

"Competitive neutrality" is multidimensional

How to support wireless and wireline carriers in a competitively neutral way

- The goal of high cost support is to achieve reasonable comparable rates and services in rural and urban areas in the presence of significantly higher costs of serving particular areas (this is "sufficient" support)
- Wireless ETCs should demonstrate where their costs pose a

significant barrier to achieving reasonably comparable rural and urban rates
- Their support will then achieve the same results
- Issues include: serving addresses, sharing of common costs, costs of CPE, and definition of areas for calculating support: wireless technology is fundamentally different from wireline technology, so these issues require technology specific treatment

Conclusions

- Forward-looking cost and rate-of-return regulation are red herrings and the cost savings are an illusion
- CETC support should be based on CETC costs and should be tailored to ensure that it achieves reasonable comparable rates and services in high cost areas
- This is consistent with section 254 and the principle of competitive neutrality adopted by the Commission and the Joint Board